

Section 252(d)(1)(A) states that rates for interconnection and unbundled network elements shall be based on "cost" and may include a reasonable profit. The ICs try to insert the word "economic" in front of the word "cost," but there is nothing in the Act or in the legislative history to show that Congress intended to limit the term in this way. The only instruction that Congress gave was that cost should be determined "without reference to a rate of return or other rate-based proceeding."⁴⁶ This is consistent with the explicit statutory requirement to determine rates through carrier negotiations, rather than through regulatory rate proceedings. It does not mean that the rates should ignore the LECs' actual costs. As NYNEX showed in its initial comments, the LECs can determine their actual costs based on their accounting records, as they have done in the past when leasing facilities to carriers, without going through a rate of return proceeding.⁴⁷

The ICs also argue that it is consistent with the intent of the Act to base rates on "economic cost," as determined by a TSLRIC methodology, because rates in competitive markets are driven to economic cost, and because rates at that level would encourage entry by other firms.⁴⁸ While it is undoubtedly true that, over time, prices in a competitive market will tend to reflect the rates of the most efficient provider, this does not mean that the Commission can force a LEC to charge rates below its own costs simply because a hypothetical new entrant

⁴⁶ 47 USC ` Section 252(d)(1)(A).

⁴⁷ See NYNEX, p. 56.

⁴⁸ See AT&T, pp. 46-47; MCI, p. 59. AT&T cites the NYNEX unbundled loop prices in New York as an example of how rates that are too high can discourage competitive entry. See AT&T, p. 45 n.62. However, as AT&T knows, the monthly charge for measured residential service in New York (\$10.10) has been set below the cost of an unbundled loop because the residential rate is heavily supported by revenues from NYNEX's access and toll services. A CLEC that buys an unbundled loop has the same ability as NYNEX to support a below-cost basic residential service rate, because it can use that loop to provide its own access and toll services. AT&T does not deny that the unbundled loop is priced at its actual cost. Therefore, the pricing of that loop is entirely consistent with the standard set forth in Section 252(d)(1)(A) of the Act.

might be able to provide service at a lower price. The marketplace can put a company out of business if it is less efficient than a competitor, but the government cannot, as a matter of law. As AT&T concedes, the law requires the government to permit a regulated company to charge rates that, as a whole, allow the company to remain in business.⁴⁹ If a regulated company is not as efficient as a new entrant, it can either find a way to reduce its costs and match the competitor's prices, or go out of business. However, the Commission cannot force that result by requiring the LECs to charge rates below their actual costs.

AT&T argues that TSLRIC pricing, "by definition," is sufficient to permit a LEC to attract capital and remain in business, because it covers all of the forward-looking costs that a LEC will incur in providing unbundled network elements.⁵⁰ There are two flaws in this argument. First, TSLRIC meets the constitutional standard only if the Commission permits rates for services that are not priced at TSLRIC to recover the costs that TSLRIC does not cover. For instance, if TSLRIC does not include a portion of common or overhead costs, the Commission must allow the LECs to increase other rates to recover those costs.⁵¹ Even in fully competitive industries, prices must be high enough to allow companies to recover their joint and common

⁴⁹ See AT&T, p. 70 & n.103, citing FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944); Duquesne Light Co. v. Barasch, 488 U.S. 299, 312 (1989) (rates are unconstitutional if, as a whole, they are so low as to "jeopardize the financial integrity of the [regulated] companies, either by leaving them with insufficient operating capital or by impeding their ability to raise future capital.")

⁵⁰ See *id.*

⁵¹ Cf. LDDS, p. 61 (arguing that interconnection rates should not include any common costs or overheads). TCG agrees that the Commission must address the issue of the definition and allocation of common costs, and that it should allocate these costs on a competitively neutral basis among all relevant services. See TCG, pp. 47-48; see also MFS, pp. 54-55. If the Commission followed the ICs' methodology and failed to allocate a reasonable amount of common costs to interconnection, it would subsidize the interconnectors and place an uneconomic burden on the LECs' retail customers.

costs if they are to stay in business. Second, the TSLRIC models proposed by the ICs are “blank slate” models that are based on hypothetical network architectures and investment levels, rather than on the LECs’ actual networks and investments. Therefore, they do not represent, in any way, the costs that the LECs will actually incur to provide service. “By definition,” this TSLRIC methodology, which does not reflect the capital costs and expenses associated with the LECs’ actual investment, would prevent the LECs from attracting capital.

The fundamental problem with applying incremental costing theory to interconnection is that the theory only accounts for the effect on costs to serve additional or new demand. If interconnection is used to replace existing access and/or local exchange services, as proposed by the ICs, it necessarily produces revenues that do not cover total costs. That would be confiscatory.⁵²

The Hatfield Model, a work in progress that AT&T and MCI offer as the definitive example of TSLRIC pricing, exemplifies the dangers in relying upon economic models as proxies for LEC costs. As MCI admits, the model produces costs that are only 44% of the LECs’ existing revenue requirements.⁵³ It is inconceivable that a LEC could stay in business if it could not recover over half of its current costs. Even if the model were used only to reprice access services, it would be devastating to the LECs. For example, if the model were used to reduce NYNEX’s access rates by 50%, NYNEX would lose approximately \$1.5 billion in annual revenues.⁵⁴ To put that amount in perspective, it is more than NYNEX Corporation’s entire

⁵² See NYNEX, p. 44 n. 87.

⁵³ See MCI, pp. 73-74.

⁵⁴ NYNEX is working on a computer model that would estimate the financial impact that would result from pricing proposals such as the Hatfield model. NYNEX will share the results with the Commission when they become available.

annual earnings from all of its operations. Obviously, a model that would wipe out the earnings of the entire corporation would not be a reasonable basis for setting interconnection rates.⁵⁵ Such rates would provide no incentive to invest in the network, assuming that the capital markets would provide the funds for such investment.

The Hatfield Model departs from economic reality in a number of ways. First and foremost, it does not represent the TSLRIC of the LECs, because it uses a hypothetical network architecture in place of the LECs' actual networks. This is a gesture of monumental hubris. The authors believe that they can design a "more efficient" nationwide telephone network on a personal computer using a handful of parameters, such as distance, population density, and soil conditions. This does not begin to represent all of the factors that a LEC must take into account in building a network that will meet the needs of its customers. NYNEX took part in the Benchmark Cost Model that formed the basis of the Hatfield Model, and we have already explained the limitations that make the model unusable for rate-setting purposes.⁵⁶ By expanding the BCM to include switching and transport investments, Hatfield has only magnified the inaccuracies which result from using the model for purposes that it was not designed to perform.

⁵⁵ The ICs assume that the LECs are wildly inefficient, and that they could return to profitability by eliminating unnecessary costs. However, NYNEX has already reduced its number of employees from a high of 95,000 in the 1980s to approximately 65,000 today. Also, NYNEX continues to reduce costs to meet the productivity standards in the Commission's price cap rules. None of the ICs has shown exactly how NYNEX, or any other LEC, could achieve the massive cost reductions that would be necessary to make a profit at the rate levels in the Hatfield Model, and certainly no IC has claimed that it could provide quality local exchange service at those levels.

⁵⁶ See NYNEX, pp. 57-60. Sprint, another co-author of the BCM, agrees that it would not be reasonable to use a proxy model such as the BCM to set rates for interconnection and unbundled network elements. See Sprint, pp. 54-55.

Second, the Hatfield Model blithely disallows major portions of the LECs' current expenses by using self-serving assumptions and estimates for loading factors. For instance, Hatfield decided that the LECs' administrative and overhead costs "seemed excessive," so he used a 6 percent factor from other industries.⁵⁷ Hatfield used a 10 percent cost of capital, regardless of the fact that massive disallowance's of the LECs' embedded investments would increase the risk, and the cost of capital, for further investments in the local exchange business. Hatfield assumed that certain network expenses varied with the dollar level of investment, which compounded the problem of underestimating the amount of network investment, and he completely omitted corporate operations and customer operations expenses.⁵⁸ In other words, Hatfield treats this as a rate case, in which he decides that certain costs are unreasonable by reference to some type of ratemaking standard, exactly the result that Congress tried to avoid.

Third, Hatfield decides that the huge discrepancy between the results of the model and the LECs' actual costs are due to inefficiencies, underdepreciation, overcapacity, and the omitted expenses.⁵⁹ He ignores the obvious reason for the discrepancy – the fact that the model uses a rudimentary network architecture that grossly underestimates the plant needed to provide quality local exchange and exchange access services.⁶⁰ The fact that the model describes costs levels that

⁵⁷ See MCI, The Cost of Basic Network Elements: Theory, Modeling and Policy Implications, p. 30.

⁵⁸ See *id.* at pp. 29, 43-44.

⁵⁹ See *id.* at pp. 37-44.

⁶⁰ Hatfield contends that the LEC networks have excess capacity. However, this merely illustrates the flaws in his model. All telecommunications networks were engineered with additional capacity to handle peak demand and growth. For example, the Commission noted in Docket 96-61 that AT&T's competitors have enough "excess capacity" to handle two-thirds of AT&T's traffic within 12 months. See Policy and Rules Concerning The Interstate, Interexchange Marketplace, CC Docket No. 96-61, Notice of Proposed Rulemaking, March 25, 1996, p. 30 n. 121.

no local exchange carrier has ever achieved, or will be able to achieve in the foreseeable future, seems to have escaped him.

AT&T argues that the LECs are not entitled to recover the amount of any shortfalls in cost recovery that would result from the model, and that no shortfalls are likely in the near future in any event, because it will take time for AT&T and others to attract customers to their competing local exchange services.⁶¹ Both contentions are wrong. The Commission does not have a legally defensible record in this proceeding for disallowing costs on a scale recommended by the ICs. Furthermore, the effect on revenues will be immediate if the Commission accepts the ICs' arguments that the ICs should be allowed to obtain interconnection under Section 251, either directly or through a CLEC subsidiary, and that the LECs should be required to "combine" unbundled network elements so that the ICs and the CLECs could obtain the same bundled local exchange functions that they receive today, but at drastically reduced prices. It would be relatively easy for ICs such as AT&T to obtain their customers' consent to obtain both their long distance and their local exchange services from their IC. In addition, by targeting the end users who make the most interexchange calls (and the ICs obviously know who those customers are), the ICs can rapidly shift the most profitable customer segment to themselves. The LECs will end up providing exactly the same services as before, but with greatly reduced revenues.

In addition to the severe financial impact on the LECs, there are broader policy implications from the use of TSLRIC pricing in general, and the Hatfield Model in particular. By pricing interconnection so low, the Commission would make it extremely difficult, if not impossible, for true facilities-based CLECs to enter the local exchange market.⁶² Even if a

⁶¹ See AT&T, pp. 70-73.

⁶² See MFS, pp. 53-55 (opposing use of LRIC to set the rates for unbundled network elements).

CLEC were the most efficient producer, the LEC could drive it out of the market by pricing its services as if it were as efficient as the CLEC.⁶³ The result eventually could be no real facilities-based competition. From the IC point of view, this would be the best of both worlds. They would get lower-priced local exchange services, and they could argue that it would not be in the public interest to allow the BOCs to enter the interexchange market, because the BOCs would be the sole providers of local exchange facilities. However, it would be a failure from the Commission's point of view, because it would not accomplish the goals of the Act. In addition, it is hard to conceive how the LECs could continue to maintain quality local exchange service, much less make any more investments in the local network, if their earnings were eliminated.

To prevent this from happening, the Commission should allow LECs to charge for interconnection and network elements based on "accounting costs" contained in the Part 32 USOA system of accounts, prior to the Part 36 separations process.⁶⁴ These costs should include direct costs and a reasonable amount of joint and common costs associated with the facilities provided to interconnectors which, for the most part, will be facilities that are already in place. These accounting costs would act as a ceiling on the rates that LECs could charge. The LECs should also be allowed to use a realistic estimate of forward-looking costs as a floor on rates for

⁶³ In its initial comments, NYNEX pointed this out as the fundamental problem with blank slate TSLRIC models such as the Hatfield Model. See NYNEX, p. 53. Competitive markets use price as the way of communicating to the consumer which producer is most efficient. Incorrect pricing signals can force the efficient producer out of business and impose costs on society to maintain operations of the inefficient producer.

⁶⁴ As NYNEX explained in its initial comments, accounting costs should be analyzed to determine whether they are relevant to the facility or function that is being provided. Costs that support the facility or function but which do not vary directly with demand for that facility or function should be considered "common costs." Where possible, common costs should be allocated based on an indirect cost causative linkage to another cost category for which direct assignment is available. When neither direct nor indirect measures are available, a general allocator should be used.

interconnection and network elements. This would give the LECs and the interconnectors room to negotiate mutually acceptable rates.⁶⁵

Some commenters urge the Commission to prohibit the States from mandating “Play or Pay” rate structures for interconnection, network unbundling and collocation.⁶⁶ “Play or Pay” rate structures for interconnection, such as the system adopted in New York, allow lower interconnection rates for carriers that assume universal service obligations. This is designed to encourage carriers to become full-service, facilities-based local exchange carriers. The Commission should address this issue in the context of its investigation of universal service issues in Docket 96-45.⁶⁷ It should not adopt interconnection pricing principles that could impede State efforts to address universal service issues.

MFS proposes what amounts to a short term marginal cost standard for collocation rates.⁶⁸ It argues that collocation rates should be based on incremental costs, which would not include any common costs or any costs for space if the LEC already had vacant space in its central office. While such costs may not be variable in the short term under certain conditions, they are highly variable under other conditions. For example, if there were no space available in a central office, the incremental cost of providing collocation for the next customer would be the cost of constructing an entire new building (after which, the incremental cost of providing collocation space to the next customer would be zero in the short term). Obviously, MFS would object to paying the cost of an entire building simply to obtain a small amount of collocation

⁶⁵ See MFS, pp. 57-59, arguing that the Commission should rely on carrier negotiations, market forces, and broad pricing parity principles to act as a discipline on carrier rates.

⁶⁶ See, e.g., TCG, pp. 48-49.

⁶⁷ See NYNEX Comments, CC Docket No. 96-45, filed April 12, 1996, pp. 15-16.

⁶⁸ See MFS, pp. 31-32.

space. Likewise, at some point, additional common costs are incurred to serve the next increment of demand. Short run incremental cost methodology would load all of the increase in common costs on the next customer. This shows that it is not feasible to base rates on short term incremental cost considerations. Therefore, if the Commission adopts incremental costing methodologies, the only practical method is to rely upon long run incremental cost, with appropriate loading factors for common costs.

VI. THE COMMISSION SHOULD ONLY REQUIRE LECs TO PROVIDE A MINIMUM SET OF UNBUNDLED ELEMENTS

In its Comments, NYNEX supported the Commission's proposal to require LECs to provide only a minimum set of unbundled network elements.⁶⁹ NYNEX recommended that the minimum set of elements subject to mandatory unbundling should be limited to the loop, switching (both end office and tandem), transport (dedicated and common), and signaling (link and STP port). Additional mandatory unbundling requirements will only serve to impose unnecessary obligations on incumbent LECs, slow down competition in the local exchange market, and delay BOC entry into the long-distance market, a result not intended by Congress. Furthermore, detailed unbundling requirements minimize the potential for meaningful State input in shaping the evolution of competition under the Act.

A. Sub-loop Unbundling

AT&T and others urge that the Commission require extensive unbundling of the network, including unbundling of sub-loops.⁷⁰ However, as Sprint and others point out,⁷¹ sub-loop

⁶⁹ The Commission must also be careful to not confuse unbundling with resale. The Act only requires that network elements be unbundled, not services. Similarly, the Act only requires that telecommunications services be offered for resale, not unbundled. Thus, a LEC has no duty to unbundle services such as call waiting or operator call competition as a network element. However, these services would be available for resale.

⁷⁰ AT&T (p. 16) seeks 11 unbundled network elements. CompTel (p. 3) seeks 16 elements.

unbundling is not necessary for a CLEC to offer competitive local exchange services to end users in an efficient manner. Furthermore, generic statements by AT&T⁷² and others that “each of the sub-loop elements uses a different type of facility or equipment or performs a different function and thus is logically separable” are at best theoretically correct. Factually, this generic classification of network architectures is wrong. These parties attempt to oversimplify the architectures used to deliver loop functionality to the end user customer. The NYNEX network is actually comprised of many different technologies, using different equipment, that is deployed in various locations with their own unique operational characteristics. For example, not all loop architectures contain concentration/multiplexing between the feeder and distribution. Furthermore, even when this type of equipment is used, the manufacturers differ and the location and accessibility to the equipment have unique operational issues associated with their deployment. In addition, many of these concentrator/multiplexers use manufacturer proprietary protocols which are not disclosable by the incumbent LEC.

AT&T’s simplified “architecture” is thus nothing more than a theoretical discussion. As NYNEX stated in its comments the Commission should not confuse theoretically possible with technically feasible.⁷³ Mandating sub-loop unbundling based on theory can only result in additional confusion and conflict. Incumbent LECs should not be required to expend substantial time and money to overcome the significant technical and operational difficulties presented by

⁷¹ Sprint, p. 31; Bell Atlantic, p. 23.

⁷² AT&T, p. 19.

⁷³ NYNEX supports USTA’s definition of technical feasibility.

sub-loop unbundling. Instead, the Commission should allow LECs to negotiate with requesting carriers the specific requirements and locations for intermediate points of loop interconnection.⁷⁴

B. Switch Unbundling

Several parties also object to LEC proposals to provide unbundled switching by offering CLECs an unbundled switch port.⁷⁵ They claim that incumbent LECs should unbundle switching capacity and provide a "switching platform" similar to that proposed by some parties to the Illinois Commerce Commission.

As NYNEX and others pointed out in their Comments,⁷⁶ an unbundled switch port gives CLECs access to local switching capability, and allows them to combine their loops with the unbundled switch to offer local exchange service. NYNEX believes that it may be technically feasible to establish a port/switching element with a usage sensitive rate that would allow CLECs to offer the services they desire without paying for switching usage based on NYNEX retail service charges.

In contrast, as Ameritech points out in its Comments,⁷⁷ the "switching platform" proposal is still in the concept stage and has not been defined with specificity by any of its proponents. In addition, as several parties point out, there are operational and security issues which are encountered as a result of "allocating capacity." For instance, LEC switches are engineered to serve current customer demand plus some degree of forecasted growth. Thus, some of the installed line capacity of a LEC switch is spare (i.e., unused). In a typical digital switch, the

⁷⁴ NYNEX supports USTA's bona fide request process as an appropriate means for seeking additional unbundling.

⁷⁵ See, e.g., CompTel, p. 33

⁷⁶ See, e.g., Bell Atlantic, p. 25.

⁷⁷ Ameritech, p. 45.

spare capacity is usually 3 to 5 percent of the total installed line capacity. This is not likely to be enough capacity to create a switch platform for even a single CLEC let alone multiple CLECs. Thus, the incumbent LEC will have to install additional capacity to serve the CLEC demand for switch platforms and maintain its own ability to serve customer demand. This immediately creates two problems.

First, a majority of CLEC customers will most likely be a result of churn (*i.e.*, not new customers but rather existing LEC customers). Assignment of customers on a line by line basis to CLECs can be more readily accommodated using the port/switch concept, rather than the "switch platform" concept.

Second, based on the existing network design and capacity, mandating the "switch platform" will result in the need to deploy additional capacity. This raises several issues. How will the additional cost for this capacity be recovered and how will the LEC guard against stranded investment when a CLEC decides to abandon the use of the LEC switch platform and deploy its own switch? There are also shared resource problems, features, options and parameters issues which impact all the lines in a given switch, and finally there are security and administration control issues which need to be addressed.⁷⁸

C. National Standards

Several parties argue that the Commission should adopt national standards for provisioning, maintenance and repair of unbundled network elements.⁷⁹ Such standards,

⁷⁸ AT&T implies that under the switch platform concept it will have the right of activating features which the LEC has not decided to use. This potential creates not only shared resource problems but creates issues related to costs and generic upgrade responsibilities (*i.e.*, if a LEC decides to upgrade a generic who is responsible for the feature used, the CLEC or the LEC.) In addition, does the feature now belong to the first CLEC to use it? What about the second CLEC who desires to use the same features?

⁷⁹ See, e.g., MFS, p. 35.

however, would inevitably fail to take into account differences in the administrative and operations support systems and test equipment utilized by LECs. Furthermore, LECs may be subject to different State service standards. As Ameritech points out,⁸⁰ the Commission has rejected mandating performance standards in the context of expanded interconnection, preferring to leave such matters to negotiations. The Commission should simply adopt a rule that requires LECs to provide the same installation, service and maintenance intervals to competitors as they do to their own customers.⁸¹ In any case, any service performance standards must include reciprocal responsibilities on the part of the competitor. Competitors must be held to the same performance and service standards and requirements as incumbent LECs. Since these requirements will vary based on geographic area, service and technology, the negotiation process and State commissions are in the best position to determine the specific responsibilities of each party.

D. Operations Support Systems

Several parties claim that the LECs should be required to provide access to their operations support systems. Indeed, MCI claims that these systems are themselves network elements.⁸² NYNEX disagrees.

The Act defines a “network element” to mean a facility or equipment used to provide telecommunications service.⁸³ Operations support systems (OSSs) are not used to route or complete calls. Thus, there is no requirement under the Act to provide CLECs with unbundled access to OSSs. NYNEX agrees that electronic gateways to OSSs are a reasonable request (see

⁸⁰ Ameritech, p. 17 n. 23.

⁸¹ See, e.g., SBC, p. 37.

⁸² MCI, p. 13.

⁸³ Section 3(45). See also Ameritech, p. 32

AT&T, p.16). However, OSSs are not network elements and unbundled access to OSSs is not required by the Act.

Any access to OSSs must be addressed on a case by case basis through negotiations and through "national standards."⁸⁴ Mandated access to LEC OSSs as network elements is not required by the Act nor is it practical on a national basis as a result of the variations in systems and uses from company to company/service to service.⁸⁵

E. Databases

Only those databases that are actually used to transmit, route and terminate traffic (such as the 800 database and LIDB database) should be unbundled on a mandatory basis.⁸⁶ Incumbent LECs strongly supported unbundling of the signaling links and STP ports that will allow access to SS7 capabilities.⁸⁷ Many have already unbundled, from a functional and pricing perspective, the access to these capabilities. e.g., 800, LIDB. However, they also strongly urged that the physical interconnection for this functional access be provided through the STP to ensure necessary gateway screening, efficient network design and available capacity for all interested parties.⁸⁸ The industry has developed interconnection and test guidelines to be used for establishing access to these databases through the STP. These practices have worked well over time and the Commission should continue to support such arrangements.

⁸⁴ Clearly such work is already in progress in a number of areas related to electronic bonding.

⁸⁵ Additionally, MCI's demand for access to OSSs as network elements can only be seen as contradictory since it claims that the existence of such systems should not be a prerequisite to technical feasibility yet claims it needs access to these OSSs for its operations. MCI, pp. 13-14. Such disingenuous claims will only slow the process of providing new entrants with the network capabilities they truly need to compete.

⁸⁶ See Ameritech's discussion of "on-line" databases for all routing and completion (pp. 48-51).

⁸⁷ See, e.g., Ameritech, pp. 46-48.

⁸⁸ See, e.g., NYNEX, p. 71; Bell Atlantic, p. 27; Ameritech, p. 50.

Many parties note that the ability to access AIN capabilities in the incumbent LECs' networks, including both the switch triggers and SCP databases, raises significant technical feasibility and network harms concerns. A significant record in CC Docket 91-346, which the Commission incorporated into this proceeding, was developed on these issues and should not be overlooked as the Commission formulates its ruling. The industry can utilize the negotiations process to determine what capabilities are provided on a technically feasible basis. However, applied in an inappropriate manner, AIN call control capabilities on a service independent basis can endanger the network's ability to process calls and the features end users have come to depend on. The Commission cannot ignore these potentials.⁸⁹

F. Collocation

Several parties claim that the Commission should require incumbent LECs to offer physical collocation at any premises where it is technically feasible, including cable vaults and manholes. They also claim that the LECs should not be allowed to restrict the type of equipment used for physical collocation.⁹⁰

As NYNEX and others pointed out in their Comments,⁹¹ the Commission has previously found that it is not feasible to provide physical collocation at LEC locations other than central offices and tandem switching locations.⁹² These conclusions still apply. The Commission further found that collocation should be limited to transmission equipment and should not extend to switches or other equipment since such equipment is not needed to physically interconnect the

⁸⁹ See, NRC Network Reliability; The Path Forward (April 17, 1996).

⁹⁰ See, e.g., MFS, pp. 22-26.

⁹¹ See, e.g., Bell Atlantic, p. 33.

⁹² Expanded Interconnection With Local Telephone Company Facilities, 7 FCC Rcd 7369, 7417-18 n. 244 (1992).

LEC's and CLEC's networks. The same rule should be followed here. Indeed, the Act only requires collocation of equipment "necessary" for interconnection or access to network elements.⁹³ Thus, mandatory collocation should continue to be limited to transmission equipment needed to interconnect with the LEC's network. No party has provided any new information which justifies, for either technical or competitive reasons, a revision of the existing rules.

VII. THE COMMISSION SHOULD ALLOW RESTRICTIONS ON RESALE

In its initial comments, NYNEX showed why the Act's obligations related to resale (a) do not require incumbent LECs to develop new or customized services desired by resellers (as opposed to making their *existing* services available for resale without unreasonable restrictions), and (b) do not limit the incumbent's rights to withdraw or modify existing services.⁹⁴ A number of commenting parties challenge this position. These challenges are meritless. To require LECs to structure their offerings not with reference to existing marketing and regulatory considerations, but with reference to the perceived needs of resellers, would turn the notion of "resale" on its head in a way that is warranted neither by the language nor the policy of the Act. As long as resellers have access to whatever services LECs offer to end users, they will be able to compete with LECs with respect to the provision of those services. The Act requires nothing more. Specifically, it does not require LECs to turn themselves into reseller service bureaus in order to guarantee to resellers the availability of any service that they desire or claim to "need", on whatever terms and conditions they desire.

⁹³ See Section 251(c)(6).

⁹⁴ Moreover, the resale construct only applies to services as they are defined in the LEC's tariffs, and not to "piece parts" of those services.

Many of the commenting parties refer to certain LECs' withdrawal and grandfathering of Centrex service (which action those parties regard as an anticompetitive affront to Centrex resellers). However, it is hard to see why the withdrawal and grandfathering of a service would prejudice resellers as long as the service remains available for resale *to the grandfathered customers*.⁹⁵ In that situation, there would be competitive parity between the reseller and the incumbent: both would be able to sell the service in question to grandfathered customers, and would not be offering it to non-grandfathered customers.⁹⁶

Moreover, it should be clear that retail services need only be offered for resale on the terms and conditions of the retail tariff. As SBC correctly points out, tariff terms and conditions that apply equally in the resale and retail markets are simply characteristics of the service being resold, not "restrictions" on the resale of that service.

Many parties attack the NYNEX argument that promotional offerings should not be regarded as "services" that are subject to resale obligations. In part, these attacks are based on a failure to distinguish between short term promotional discounts and more or less permanently discounted services, a distinction which NYNEX clearly drew in its initial comments. Cable & Wireless takes a different tack, raising the specter that promotional offerings will be priced at anti-competitively low levels.⁹⁷ However, if such problems exist, they have nothing to do with

⁹⁵ Although NYNEX does not believe that grandfathered services should be made available for resale to the public at large, it does not object to their resale to grandfathered customers.

⁹⁶ MFS argues (at 71-72) that an incumbent "may not 'grandfather' [a] service so that some resellers can continue in business while others are precluded from entering the market." However a distinction between existing and future customers (and, implicitly, between the carriers who seek to serve such customers) is implicit in the notion of grandfathering. As State commission decisions approving grandfathering arrangements make clear, in appropriate cases such distinctions are neither unreasonable nor violate state anti-discrimination requirements.

⁹⁷ Cable & Wireless, p. 42.

resale. State and federal law restrictions on predatory pricing should suffice to deal with claims that promotions are priced anti-competitively.

A number of parties recognized the reasonableness of enforcing class-of-customer limitations in the resale context. The Department of Justice and others, however, argue that such restrictions should be permissible only “where a residential service can be shown to be priced below cost as a matter of regulatory policy.”⁹⁸ However, there is no reason why below-cost pricing should be required. Whenever a service is required to be priced at a particular, non-market-based level (whether above or below cost) when offered to a particular class of customers: (a) that requirement represents a State policy judgment that should be respected in the resale context, and (b) a facilities-based LEC should not be faced with the burden of offering the “special” price in a circumstance where the underlying policy (protection of a particular customer class) is inapplicable.

Some parties argue that the Act requires incumbent LECs to implement various kinds of interfaces and administrative and service-ordering systems for resellers, and that the Commission should issue regulations addressed to that requirement, including the detailed specification of operational standards. However, nothing in the Act imposes such a requirement, and the Commission should eschew an approach which would turn the Act into a general remedy for every sort of problem or need that is claimed to exist. Although NYNEX believes that the use of electronic interfaces can be helpful in enabling LECs to achieve cost avoidance in the resale context, and is in the process of developing and implementing such interfaces, we believe that interface requirements should be determined, to the greatest extent possible, through negotiation

⁹⁸ DOJ, p. 54.

between the interested parties. There is simply no basis for mandating uniform nationwide standards at this time.⁹⁹

The American Public Communications Council argues that independent payphone providers (IPPs) should be guaranteed the right to obtain the products that they use to provision their payphone service (e.g., "PAL" lines) at wholesale rates. However, merely characterizing the relationship between IPPs and incumbent LECs as "resale" would not change the underlying ordering or provisioning systems for such products, and thus would not lead to any avoided costs. The situation should be distinguished from cases in which resellers would interpose themselves between incumbents and their existing retail customers, and thus enable the incumbents to avoid some portion of the costs they incur in dealing with those customers. In the latter situation, the advent of resale would actually enable the incumbents to change the costs they incur in providing service. This would not be true in the IPP case, and IPPs should not, merely by labeling their relationship with incumbents as "resale," be allowed to reap the benefits of a lower price without enabling any new cost avoidance.

Moreover, IPPs, analogously to interexchange carriers, merely *use* PAL service to provision the coin service that they offer to end users. That situation should be distinguished from the type of "resale" that warrants the offering of wholesale discounts under the Act.¹⁰⁰

⁹⁹ Moreover, some operational standards may implicate important state policies relating, e.g., to the privacy of customer records.

¹⁰⁰ The conceptual difficulties of applying wholesale pricing rules to IPPs are illustrated by the strained reasoning by which APCC (at 2-3) argues that IPPs simultaneously are and are not "telecommunications carriers." IPPs should be distinguished from the type of reseller that would buy PAL lines in bulk from the incumbent and resell them to multiple IPPs.

VIII. ONLY NET AVOIDED COSTS SHOULD BE EXCLUDED FROM THE PRICING OF SERVICES OFFERED FOR RESALE UNDER SECTIONS 251(c)(4) AND 252(d)(3)

In its initial comments, NYNEX showed why the statutory "avoided cost" pricing formula for services offered for resale would only result in economic efficiency if it were properly interpreted and applied. Such correct application of the standard requires the following:

- (a) Only variable costs that would actually be avoided as LEC services shift from retail customers to wholesale customers should be subtracted from the retail price;¹⁰¹
- (b) Fixed overheads and "contribution" should not be included in avoided cost;
- (c) Avoided cost must be computed net of any cost onsets associated with serving resellers;¹⁰² and
- (d) Avoided cost does not include the cost of providing features and functions that are part of the service being resold, but that resellers may decide that they do not want or need. (To allow resellers to manipulate the avoided cost formula in this manner would impose - without any justification in the language or policies of the Act - a requirement that incumbent LECs custom design services for the benefit of resellers, rather than merely making their existing services available for resale.)

Any other interpretation of "avoided costs" (for example, interpretations that focus on whether a discount "permit[s] viable competition" (*see* AT&T, p. 85) are simply not authorized by the Act.

¹⁰¹ Costs that are not avoided cannot be avoided costs. As this formulation illustrates, the requirement is obvious to the point of tautology. We mention it only in response to the numerous parties who have advocated wholesale pricing formulas that are not based on what costs are actually avoided.

¹⁰² This is not to say that gross avoided costs and cost onsets must be melded into a single discount percentage. Another possibility is the recovery of cost onsets through separate charges. Some parties argue that there is no statutory basis for allowing the recovery of cost onsets. However, taking such onsets into account is necessary to the proper computation of avoided cost. (If a carrier has to spend \$6 to save \$10, the cost that it avoids is not \$10 but \$4.) "Avoided cost" in this context clearly means net, not gross, avoided cost.

Numerous parties have proposed “adjustments” to the retail price that have nothing to do with cost avoidance. The Commission must resist these proposals which seek to require incumbent LECs to set wholesale prices for their services in a manner that is not authorized by the Act. The attempts by these parties to force LECs to inflate their avoided costs is not only inconsistent with the clear language of the Act, it would also be contrary to public policy since it would unfairly favor resellers over incumbent LECs themselves and over the facilities-based CLECs that compete both with resellers and incumbents.

For example, ACTA argues that “retail prices [should] be adjusted to eliminate the portion that would no longer exist if the LEC withdrew entirely from the retail service business.”¹⁰³ But that is not what the Act says. Section 252(d)(3) only requires the exclusion of “costs that will be avoided by the local exchange carrier.” Costs that the LEC would not incur in some hypothetical “no-retail” scenario, but that it would incur in the real world, can not be considered to be “avoided”.¹⁰⁴

The avoided cost formula should only be mandated on an aggregate basis. In other words, the LECs’ wholesale prices for all of its retail services should in aggregate be equal to retail price less avoided costs. The aggregate basis should meet the statutory requirement as long as there is a reasonable relationship between avoided costs and a particular service. Requiring an exact relationship may not be achievable in a meaningful fashion on a per service basis. For example, NYNEX has found that data to support service-by-service avoided cost studies for all

¹⁰³ ACTA, p. 27. See also ACTA, p. 28 (“A cost study which had the objective of measuring cost changes that would occur if 100% of services available for resale were converted from a retail environment to a wholesale environment, is a conceptually correct starting place.”)

¹⁰⁴ Indeed, this proposal would confuse two separate pricing constructs in the Act, by shifting the inquiry from what costs would be *avoided* by resale to what costs are *incurred* in resale. The Commission must give effect to Congress’ decision to establish distinct pricing standards for different types of products (network elements, services offered for resale, etc.).

retail services may not be readily available, and that in some cases applying the avoided cost formula in the aggregate would be, for all practical purposes, the best that could be done. However, the computation of avoided costs on an aggregate basis does not mean that the same percentage discount must be applied to all services. Within the framework of meeting the avoided cost test in the aggregate, LECs should have flexibility to adopt reasonable wholesale rate structures as long as the overall rates remain close to the total level of avoided costs. Contrary to the claims of some parties,¹⁰⁵ rate structures involving term and volume discounts should not be precluded.

IX. THE STATUTORY REQUIREMENT OF RECIPROCAL COMPENSATION FOR THE “TRANSPORT AND TERMINATION” OF CALLS DOES NOT ENCOMPASS COMMISSION-MANDATED RATE STRUCTURES OR LEVELS

Under Section 251(b)(5), the LECs have “a duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.” The Commission inquires whether it is authorized to promulgate rules to guide the States in applying Section 252(d)(2) as to rate structure and rate levels, and specifically whether “symmetrical” or “Bill-and-Keep” arrangements may be required (NPRM ¶¶226-244). In fact, Section 251 does not authorize the Commission to establish mandatory rate structures or rate levels (NYNEX, pp. 84-90).

A. The Rate Structure For Transport and Termination Should Not Be Set By The Commission

There can be no question that the Act does not countenance a single federal rate structure. Rather, these are to be negotiated by the carriers under Section 252 pursuant to State processes. Nevertheless, some commenters ask the Commission to specify a flat-rated structure.¹⁰⁶

¹⁰⁵ Cable & Wireless, p. 48.

¹⁰⁶ See, e.g., Teleport, p. 74.

Although this may be appropriate with respect to the recovery of some costs, it may not be appropriate for other costs. NYNEX is not opposed to capacity-based, flat rate interconnection charges (as negotiated) in specific circumstances. However, the Commission should refrain from dictating a particular rate structure for all circumstances, and leave to the interconnecting parties the determination of a proper rate structure for their agreements.

Similarly, there is no basis for the Commission to pre-set a single “transport and termination” rate element, as some request.¹⁰⁷ For example, some commenters ask the Commission to override state regulatory schemes that have established different interconnection charges for tandem and end office connections, such as New York has done.¹⁰⁸ There is no basis in law for such a federal override of carefully drawn state policy and, indeed, such a determination would conflict with the cost recovery requirements of Section 252(d)(2) --unless all interconnection were priced to include the more costly provision of “transport and termination,” clearly not the result commenters seek to secure.

B. The Rates Between Parties For Reciprocal Compensation Should Be Agreed Upon At Levels At Least Equal To Each LEC's Additional Costs

NYNEX earlier showed that the statute did not require symmetrical rates or contemplate that the Commission set specific rates for reciprocal “transport and termination” of another carrier’s local exchange traffic (NYNEX, pp. 86-88). Further, we showed that mandated “Bill-and-Keep” arrangements were contrary to both the statute and good economic policy, although we refrained from detailed argument at the Commission’s request (NYNEX, pp. 89-90.)¹⁰⁹

¹⁰⁷ See, e.g., NCTA, pp. 48-49.

¹⁰⁸ See, e.g., Time Warner, pp. 86-88; MFS, p. 78. This State policy parallels the differentiated cost-based rate structure used in federal access charges.

¹⁰⁹ NPRM ¶242. Instead, NYNEX pointed to the detailed statements of law and economic policy provided with its Comments and Reply Comments in CC Docket 95-185.

(1) Symmetry

Many commenters recognized with NYNEX that the Section 252 (d)(2) standard of cost recovery for “each carrier” precluded the imposition of symmetrical charges.¹¹⁰ Nevertheless, many seem to understand (as NYNEX does) that symmetrical arrangements may be one logical result of the negotiation process.¹¹¹

Remarkably, some commenters argue that symmetry is compelled by statute, all but ignoring the statutory standard requiring recovery of “each carrier’s” costs.¹¹² Several seek to argue their way around the statute by substituting hypothetical, “optimal” network costs alleged to be equal for all carriers.¹¹³ Of course, this is not the Congressional standard, and it is not even good policy. Indeed, it seeks to replace the real network costs of call “transport and termination” with some imaginary network; a standard which, if adopted, will deny LECs their necessary cost recovery, send improper signals to customers, and impair prudent investment decision making on both sides of the interconnection.¹¹⁴ The real effect of these hypothetical models will likely be: (1) the suppression of facility-based competition, as potentially competitive providers determine that they cannot build the “optimal” networks they envision; and (2) an increased cost of capital, at least, for LECs as they are forced to seek recovery of their actual costs from other customers.¹¹⁵

¹¹⁰ See, e.g., AllTel, p. 15; Sprint, p. 83 (statute does not permit a “hard and fast” rule).

¹¹¹ See, e.g., Mass DPUC, pp. 13-14.

¹¹² See, e.g., MCI, p. 51.

¹¹³ See, e.g., MFS, pp. 80-81

¹¹⁴ Indeed, a recurrent flaw in commenters’ arguments is that they focus on “economic efficiency” only on their side of the interconnection, causing suboptimal economic results overall.

¹¹⁵ To the extent that others, like AT&T, see mandated symmetry as an appropriate “interim” directive, they request relief that goes beyond the statute (AT&T, p. 69). Moreover, there is the perverse incentive in any such directive for parties to deadlock negotiations to achieve

(2) "Bill and Keep" Compensation Agreements

It is not surprising that the Commission's inquiry concerning the potential imposition of "Bill-and-Keep" arrangements has drawn vigorous interest from wireline as well as wireless competitors.¹¹⁶ Fundamentally, they see in Commission-mandated "Bill-and-Keep" a means by which they can avoid the costs of LEC call-terminating services by essentially transferring this cost burden to other LEC customers.¹¹⁷ Most recognize therefore that they must minimize this "burden" or prove that same public interest exigency requires that it be ignored. Even then they must show that such conclusion is consistent with the Communications Act. They do not meet this test.

The wireless carrier arguments for Commission-mandated "bill-and-keep" arrangements have already been made and answered in Docket 95-185.¹¹⁸ Notwithstanding the Commission's admonition that they not be reargued herein (NPRM ¶ 242), they are largely all presented again. For example, it is argued that LEC-PCS traffic is already in balance, based on the experience of APC in Baltimore.¹¹⁹ In fact, under conditions strongly favoring "in-bound" PCS traffic, APC's experience still reflects 30 percent greater outbound traffic.¹²⁰ It is also argued that current

this "default" position. The Commission should let the statute speak for itself as to "reciprocal compensation arrangements" without direction as to their "symmetry."

¹¹⁶ See, e.g., PCIA, pp. 14-16, Time Warner, pp. 92-102.

¹¹⁷ See discussion of "free-riding" by Prof. Hausman, Affidavit accompanying Comments of Bell Atlantic, at ¶¶ 10-13.

¹¹⁸ In The Matter of Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, Notice of Proposed Rulemaking, CC Docket 95-185, 61 Fed Reg. 3644 (1996).

¹¹⁹ See, e.g., PCIA, p. 15.

¹²⁰ NYNEX Reply Comments, CC Docket 95-185, filed March 25, 1996, at pp. 9-10 ("Reply"). Prospective PCS interconnectors do not indicate that they will adopt APC's favorable practices (e.g., first minute free), nor should they be so required. Further, the imbalance is even greater for cellular traffic (i.e., NYNEX LECs terminate six (6) times as many CMRS-LEC calls in their region than do cellular interconnectors).